Using PPPs in World Bank's Classifications of Countries by Income Level

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BACKGROUND

The World Bank classifies countries by income level to meet two distinct objectives:

- **Operational** – *determine lending terms*

    - Distinguish between countries eligible for concessional finance from the International Development Association (IDA), for finance on market terms from the International Bank of Reconstruction and Development (IBRD), or neither due to high income levels.

- **Analytical** – *broadly group countries by level of development - economic capacity*

    - Group countries by: Low income; Lower middle income; Upper middle income; and High income

- **Statistical basis for both classifications**: Gross National Income (GNI) per capita converted to a common currency using market exchange rates, with *ad hoc* adjustments to mitigate short term fluctuations and to reflect available information on parallel market exchange rate (i.e. "Atlas" conversion factors).

CURRENT 'ATLAS' VS PPP-BASED METHOD

Atlas adopted as an interim measure until PPPs were sufficiently developed

- Current method in place for nearly 40 years, with only minor adjustments since the early 1980s.
- PPPs are long-recognized as more conceptually appropriate than market exchange rates.

Atlas conversion factors are used to convert GNI per capita to US dollars

- 3-year average of market exchange rates adjusted for short term distortions due to inflation
- Market exchange rates account, to the extent possible, for currency controls and **parallel exchange rate activity** resulting from black market or informal transactions

Atlas GNI per capita compared to **thresholds**, updated annually, to divide countries into groups

- Thresholds updated with the **Special Drawing Rights (SDR) deflator**.

➤ **PPPs circumvent challenges/limitations of Atlas method (**adjustments for parallel exchange rate markets, averaging to mitigate short term fluctuations…**)**

CONSULTATIONS

- Results and findings of a **World Bank draft technical paper** presented at the ICP TAG in December 2022:

  - PPP based methodology

  - Simulated country impacts for analytical and operational classifications

  - Tested plausibility: correlations with development indicators

- **Internal and external consultations** on appropriate transition to PPP methodology:

  - Operational classification: analysis of financial and operational impacts for the World Bank using 2021 database underlying consultation paper

  - Analytical classification: targeted consultation of administrative/regulatory users

    IMF, OECD, UN, Asian Development Bank, Global Fund, Millennium Challenge Corporation

HIGHLIGHTS OF CONSULTATIONS

- **World Bank operations and financing**

  - Analysis of financial and operational impacts completed in summer 2023

  - Impacts assessed to be manageable

    - Timing of IDA replenishment cycle an important factor

    - No need for transitional classification

- **External consultations**

  - General support for new approach; no "showstoppers"

  - Transitions to be managed on an individual "customized" basis if both current and new classifications are maintained for a sufficient period.

NEXT STEPS

Targeting a transition in FY2025

- To be confirmed pending broader consultations within the World Bank in collaboration with internal partners

World Bank technical paper to be published

External communication strategy developed

THANK YOU!!